Internal Revenue Service
memorandum

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Br2:ORPirfo

date: AUG 8 1991

to: District Counsel, [redacted]
Attention: Karen J. Goheen, Special Litigation Assistant

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: [redacted] - Statute Extensions
Taxable Years [redacted], [redacted], and [redacted]

This is in response to your recent request for advice with regard to (1) the validity of previously executed waivers of the period of limitations on assessment and (2) the course of action to be pursued now to extend any further that period.

ISSUES

1. Which corporation in a reorganized consolidated group of corporations, as described in the facts below, is the proper party to execute a consent to extend the statute of limitations for assessment of income tax for taxable years [redacted], [redacted], and [redacted], where the common parent for those taxable years has since gone out of existence by way of a merger.

2. In order to protect best the government's interest, what other consents or agreements with respect to transferee liability should be obtained and from which corporation should these be secured.

FACTS

The facts are as described by Karen J. Goheen, Special Litigation Assistant, to Oreste Russ Pirfo of this office in their telephone conversations and as reflected in the various documents submitted to us. The material facts may be summarized as follows:

[redacted], EIN [redacted], incorporated in [redacted], was the common parent of an affiliated group of corporations which filed consolidated returns for the taxable years in issue ([redacted], [redacted], and [redacted]). These returns were filed, respectively, on [redacted], [redacted], and [redacted]. All three returns were signed by "[redacted], Assistant Secretary."

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Before the normal three-year statute of limitations for assess nt of income tax[1] had run on any of the aforementioned taxab years, taxpayer organized certain new corporations and realigned the existing group effective as of [redacted].

In that [redacted] reorganization, shareholders of [redacted], EIN [redacted] (hereinafter, the old common parent or "old" [redacted]) received in exchange for their stock, on a share-for-share basis, the stock in the newly created [redacted], EIN [redacted]. The latter then changed its name to [redacted] (hereinafter, the new common parent or "new" [redacted]). The old common parent remained in existence; but, it changed its name to [redacted] and became a subsidiary of "new" [redacted].[2]

After the [redacted] reorganization, the Service sought to extend the period of limitations for assessment on the earlier years under audit. To that end, it obtained a series of three Forms 872. These were executed in [redacted], [redacted], and [redacted]. The purported net effect of these agreements was to extend the period of limitation for assessment until [redacted], for all three of the taxable years in issue. All of these Forms 872 were titled and signed in the name of: "[redacted]." The EIN reflected in the space designated on each Form 872 was "[redacted]," which was that of the old common parent. The corporate officer signing the three consents was the same "[redacted], Assistant Secretary" who had signed the corporate tax returns involved.

After the execution of the last of these three extension agreements, in late [redacted], the taxpayer decided to eliminate the holding company structure of the group. Consequently, effective [redacted], [redacted] (the old common parent) merged into [redacted] (the new common parent), with the latter surviving. Both corporations were organized under the law of Delaware and the merger was pursuant to that law. See Del. Gen. Corp. Law § 259(a). As a consequence, [redacted] thus ceased to exist as of the time of the merger for any purpose

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[1] See I.R.C. § 6501.

[2] [redacted] was actually a second-tier subsidiary of "new" [redacted]. [redacted] was owned by [redacted] which was in turn owned by "new" [redacted].

relevant here. See id.[3]

As of the time of this [redacted] reorganization and merger, per the earlier Forms 872, the period of limitations for assessment was scheduled to expire on [redacted]. Before such expiration date, another Form 872 was secured in [redacted] purporting to extend the time for assessment for all three taxable years until [redacted]. That fourth and final Form 872 was executed in the same manner as the three earlier ones discussed above. As such, it carried the name and EIN of the now-defunct old common parent.

To date, no transferee agreements or consents to extend time for the assessment of any transferee liability have been secured.

DISCUSSION

The period of limitation for assessment against a taxpayer under I.R.C. § 6501(a) is three years after the return is filed, except where the taxpayer and the Commissioner have entered into a written agreement to extend the time prior to the expiration of that three-year period. See section 6501(c)(4). The period so extended may be further extended by subsequent additional agreements again entered into prior to expiration of the preceding agreement. Id. The period for assessment against an initial transferee is one year after the expiration of the period for assessment, as extended, against the transferor. Section 6901(c).

As the general rule, Treas. Reg. § 1.1502-77(a) provides that the common parent is the sole agent for each subsidiary in the consolidated group filing a consolidated return. Expressly included within the authority of the common parent is the power to execute in its name any waivers of the statute of limitations for assessment. Such waivers so given shall be considered as

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[3] But see Del. Gen. Corp. Law § 261, as to the continued existence of a corporation formally terminated by merger where an "action, suit, or proceeding" is pending at the time of the merger. Notwithstanding this provision, it appears well-settled that the fact that a federal income tax audit was in progress, without more, will not be found tantamount to a "proceeding." See, e.g., Paramount Warrior, Inc. v. Commissioner, 35 T.C.M. 1805 (1976); Field v. Commissioner, 32 T.C. 187 (1959), aff'd per curiam, 286 F.2d 960 (6th Cir. 1960); American Standard Watch Co. v. Commissioner, 229 F.2d 672, 675 (2d Cir. 1956); Brannon's of Shawnee, Inc. v. Commissioner, 71 T.C. 108, 115 (1978); Badger Materials, Inc. v. Commissioner, 40 T.C. 725, 732-33 (1963); Wheeler's Peachtree Pharmacy, Inc. v. Commissioner, 35 T.C. 177, 182-83 (1960).

having also been given or executed by each member subsidiary. Under Treas. Reg. § 1.1502-6(a), each subsidiary is severally liable for the entire tax for the consolidated return year.

The [redacted] reorganization, however, was a "reverse acquisition" under the consolidated return regulations. See Treas. Reg. § 1.1502-75(d)(3). A reverse acquisition occurs when a corporation (the "first corporation" under the regulation) acquires the stock or substantially all of the assets of another corporation that is a member of a consolidated group (the "second corporation") and the shareholders of the second corporation end up owning more than fifty percent of the stock of the first corporation immediately after the acquisition. Id. In such cases the first corporation becomes the new common parent for the group. The group of which the second corporation was a member is treated as remaining in existence with the new common parent.

With respect to the consolidated return years prior to a reverse acquisition, it is the Service's position that when the old common parent (the "second corporation") remains in existence after the acquisition, the old common parent remains the common parent agent for the group for those prior years. In other words, the general rule of Treas. Reg. § 1.1502-77 still applies.

In the [redacted] reorganization, the old common parent ([redacted] EIN [redacted]) remained in existence; hence, it is our position that that corporation (later renamed [redacted])[4] remained the common parent for the taxable years prior to the acquisition. See Treas. Reg. § 1.1502-77(a); compare Southern Pacific Co. v. Commissioner, 84 T.C. 375 (1985) (where the old parent went out of existence in the acquisition, this is discussed further below). Accordingly, it is our view that the three Form 872 extensions obtained after the [redacted] reverse acquisition and before the [redacted] reorganization were all properly executed under the EIN and in the name of the old common parent.

Notwithstanding our position, the taxpayer may argue that the new common parent, [redacted], EIN [redacted], should have been treated as the new agent for the group for those earlier years. This presents some litigating risk for the Service, since Southern Pacific, supra, only dealt with a situation where the old common parent went out of existence at the time of the reverse acquisition. It did not specifically address the circumstances, as here presented, where the old common parent remained as a subsidiary member of the group.

The holding in Southern Pacific should not be extended to the instant case since "old" [redacted] (then renamed [redacted]) was

[4] The name change is of no significance for our purposes.

still in existence as of the times at which the first three Form 872 consents were executed.[5] As the following analysis shows, Southern Pacific is distinguishable from the instant case where the old common parent remained in existence.

A reading of the Southern Pacific cases reveals that the Government's argument (that the reverse acquisition rule of Treas. Reg. § 1.1502-75(d)(3) required that new common parent be recognized as the successor agent for preacquisition tax years) was just a responsive argument to the petitioners' assertion that Treas. Reg. § 1.1502-77(d) (or its predecessor provision Treas. Reg. § 1.1502-16A(c)) was the controlling provision. Stated another way, at issue in the Southern Pacific cases was whether either the designation rules of Treas. Reg. § 1.1502-77(d) (and its predecessor 1.1502-16A(c)) or the reverse acquisition rule of Treas. Reg. § 1.1502-75(d)(3) should dictate which corporation is the proper successor agent of the group.

Since the old common parent here, [redacted], did not cease to exist in the reverse acquisition, the designation rules of Treas. Reg. § 1.1502-77(d) are not applicable. Instead, the issue presented is whether either the reverse acquisition rule of Treas. Reg. § 1.1502-75(d)(3) or the general common parent agency rule of Treas. Reg. § 1.1502-77(a) dictates which entity is the proper agent for the group for the preacquisition years. The facts here thus present an issue not addressed by the Southern Pacific court.

A key distinction between this case and the Southern Pacific cases is that in the latter the reverse acquisition was an asset acquisition (the assets of the old common parent) while here the reverse acquisition was a stock acquisition (the stock of "old" [redacted]). A reading of both Southern Pacific opinions reveals that, despite the fact that the old common parent there was merged into a wholly-owned subsidiary of the new common parent, the Tax Court considered the new common parent, and not the surviving subsidiary, to be the successor to the old parent. The

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[5] Establishing the validity of this series of three consents should be sufficient to support at least transferee liability for "new" [redacted] -- despite "old" [redacted]'s ultimate termination in the [redacted] reorganization. This is because these consents extended the statute as to the original liability of the transferor until [redacted], and a one year period of transferee liability therefrom will run until [redacted]. See section 6901(c). This affords us the opportunity to obtain a timely extension from new [redacted] with regard to that transferee liability (Form 977) before the end of this calendar year or, alternatively, issue a notice of transferee liability to "new" [redacted]. Note that this transferee liability runs only against "new" [redacted], not its subsidiary corporations.

Tax Court analyzed the reverse (asset) acquisition by concluding that the substance of the transaction was an asset acquisition by new parent with a simultaneous "drop down" of the operating assets to its wholly-owned subsidiary. Moreover, the Tax Court viewed the fact that the old common parent was merged into a new subsidiary member, and not the new common parent as a matter of form only. Based upon this analysis, the Tax Court in Southern Pacific concluded that, in substance, the new common parent was merely a continuation of the former common parent corporation. 84 T.C. 387.

The Tax Court recognized that Treas. Reg. § 1.1502-75(d)(3) constitutes a substance-over-form position. That is, the approach adopted by the regulation is that where there is sufficient shareholder continuity from the acquired corporation to constitute control of the acquiring corporation the substance of changes in the group's corporate structure should control for purposes of all consolidated return provisions. 84 T.C. 386. Consequently, the Southern Pacific cases can be explained on the basis that, although in form old SP went out of existence through its merger into SPTC, in substance old SP was merged into new SP. Since the Court treated new SP as a continuation of old SP, new SP was entitled to succeed to old SP's agency capacity for purposes of Treas. Reg. § 1.1502-77.

By contrast, in the instant case, since new [redacted] acquired the stock rather than the assets of old [redacted] and since old [redacted] survived the reverse acquisition, no reasonable argument can be made in this case that new [redacted] was in substance the successor corporation to old [redacted].[6]

Southern Pacific, 84 T.C. 395, at 404, also contains the following language:

> Accordingly, we hold that the reverse acquisition rule applies in determining which entity succeeds the common parent as agent for the affiliated group with respect to years both before and after the reverse acquisition.

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[6] The successor rationale, spelled out above, was only relied upon in one of the Southern Pacific cases. See 84 T.C. 375. That case considered tax years 1962-1965. Since both Southern Pacific cases were addressed to the same reverse acquisition rule of Treas. Reg. § 1.1502-75(d)(3) and since section 1.1502-77(d) and its predecessor section, 1.1502-16A(c), are substantially alike, we see no reason why such a rationale should not be equally applicable to later tax years.

> It follows from our view of the scope of the operation of the rule that section 1.1502-75(d)(3), Income Tax Regs., effectively overrides Section 1.1502-77, Income Tax Regs., with respect to a determination of the successor agent for preacquisition years following a reverse acquisition.

Taxpayer could argue that this language means that in any reverse acquisition, the new common parent is always the proper agent for all tax matters, including consents, with respect to preacquisition tax years.

In sum, we take the position that the Tax Court in Southern Pacific refused to apply § 1.1502-77(d) to the facts of that case, because even though the old common parent there did go out of existence, the Tax Court concluded that the application of the reverse acquisition rule of Treas. Reg. § 1.1502-75(d)(3) was consistent with a recognition that in substance new SP was a continuation of old SP. As such, the application of Treas. Reg. § 1.1502-75(d)(3) dictated that new SP succeeded to old SP's agency authority for preacquisition tax years following the reverse acquisition. In that manner, it can be said that section 1.1502-75(d)(3) effectively overrode section 1.1502-77(d).

In our case, however, the form of the reverse acquisition is identical to the substance of the transaction i.e., a stock acquisition by new [redacted] of old [redacted]. The old corporation did not cease to exist and, therefore, the application of Treas. Reg. § 1.1502-75(d)(3) does not warrant a conclusion that new [redacted] was in substance a continuation of old [redacted]. Accordingly, we believe that the instant case is distinguishable from the Southern Pacific cases so that the application of the agency rules of Treas. Reg. § 1.1502-77(a) to this case is in no way affected by the reverse acquisition rules.

We turn now to the relevant effects of the late-[redacted] reorganization and merger of old [redacted] into new [redacted] Recall that it was at that time that old [redacted] actually was terminated.

To date, the only Form 872 executed[7] after this [redacted] transaction was titled and signed in the same manner as were the first three consents: "[redacted], EIN [redacted]," (i.e., the name and number of the old common parent). While we will consider here the validity of this fourth consent, irrespective of whether it is found binding, new [redacted] should still be liable as a transferee of the old

[7] This consent is dated [redacted].

[redacted] until [redacted] anyway.[8]

Since "new" [redacted] succeeded to the federal income tax liability of "old" [redacted] by operation of state law, it necessarily succeeded to any rights to extend the time for the assessment of that liability. In our view, this succession to the right to agree to extend the statute of limitations is provided for specifically in Del. Gen. Corp. Law § 259(a):

> [T]he rights, privileges, powers and franchises of each of said corporations * * * shall be vested in the corporation surviving or resulting from such merger or consolidation[.]

As was succinctly stated by the Court of Chancery of Delaware in Fitzsimmons v. Western Airlines, 290 A.2d 682, 685 (1972):

> It is thus a matter of statutory law that a Delaware corporation may not avoid its contractual obligations by merger; those duties "attach" to the surviving corporation and may be "enforced against it." In short, the survivor must assume the obligations of the constituent.

If Delaware law controls, as it must, then the obligations of old [redacted] automatically attached to its successor new [redacted]. While post-merger waivers were executed under the name and EIN of the terminated old [redacted] the underlying potential income tax liability had "attached" to new [redacted] by operation of law and, it could be argued if necessary, that new [redacted] was extending the time for assessment in its own capacity as the successor corporation or at least the agreement should be so construed.[9]

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[8] Even if this fourth Form 872 is valid as to new [redacted], it did nothing to extend the primary several liability of the subsidiary members of the old group. This is because, while "new" [redacted] may have succeeded to the primary liability of "old" [redacted] by operation of state law and pursuant to a merger agreement, it did not also succeed to the common parent role by way of that merger under the consolidated return regulations. [redacted] -- absent an appropriate designation and approval in accord with the -77(d) regulation -- was the only corporation able to bind the old subsidiaries under the regulations. [redacted] had gone out of existence [redacted] months before this waiver was ever executed; hence, its former subsidiaries were not bound.

[9] Unless "new" [redacted] challenges the Service's claim that "new" [redacted] was a transferee of "old" [redacted] and prevails, the ultimate resolution of the statute of limitations issue in this case will not have to revolve upon whether the [redacted] Form 872 is valid.

There is a probable problem with this position. Simply put, the consent was, after all, executed under the name and EIN of a defunct corporation. There is no direct authority for a successor corporation to do the like under the Delaware statutes nor in any of the cases we have found. Thus, it could be argued that the consent had no legal effect. Certain equitable estoppel arguments could be developed to support the validity of this particular consent. See, e.g., Illinois Addressograph Manufacturing Co. v. Commissioner, 31 B.T.A. 498 (1934); Paramount Warrior, supra, at 1811-12; Badger Materials, supra, at 733.

Because of the high uncertainty as to the validity of this fourth Form 872, it is imperative that the transferee liability be carefully protected. We are still in the original one-year transferee liability period until [redacted], under section 6901(c).[10] New [redacted] may extend this period by signing a Form 977 extension. We suggest that you obtain such consents as well as a Form 2045 transferee agreement acknowledging new [redacted]'s status. We understand that you are confirming your representation to us that the [redacted] merger agreement between old and new [redacted] states that new [redacted] assumes all the debts and obligations of old [redacted].[11]

We caution you not to secure the Forms 977 to the exclusion of additional Forms 872. Although there may be a problem with the last Form 872 obtained, do not forego this additional avenue of possible protection. In the future, however, these Forms 872 must reflect the actual current status of the corporations involved. These should be executed by new [redacted] "as successor by merger" to old [redacted], and reflect both EIN's in the title. We suggest specific language below in our Recommendation. These

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[10] This is assuming, of course, that the three pre-[redacted] Forms 872 are held valid.

[11] Transferee liability may arise "at law" or "in equity." This distinction is a function of whether the transferee specifically agreed to undertake the obligations of the transferor (law) or whether the transferee simply received the assets of the transferor as a distributee without agreeing to meet any obligations (equity). Transferee liability in equity is limited to the value of the assets transferred; however, depending upon the agreement of the parties to the transaction, transferee liability at law may not be so limited. Jahncke Service, Inc. v. Commissioner, 20 B.T.A. 837, 846 (1930); see also Southern Pacific, supra, 84 T.C. 387, 393-95. We conclude that the liability of "new" [redacted] is one of transferee at law based on our assumption that it expressly assumed the obligations of "old" [redacted].

new Form 872 consents may be argued to be invalid by the taxpayer because of a problem in the "chain" as discussed above. Nonetheless, having these consents may prove valuable in court anyway, if need be, for use as evidence with regard to possible equitable estoppel or equitable reformation of contract arguments based on what the parties actual intentions were all along.

CONCLUSION AND RECOMMENDATION

For the reasons discussed above, we conclude that the three Forms 872 obtained from the taxpayer after the [redacted] reverse acquisition but before the [redacted] reorganization and merger were properly executed by that former common parent and valid for purposes of extending the period of limitation for assessment of the [redacted] through [redacted] consolidated return years until [redacted]. This position may be challenged by the taxpayer by the argument that the new common parent had also become the agent for the preacquisition years. Such an argument by taxpayer should be countered with the reasoning set out in the discussion above. Please notify us as soon as possible should it become clear that the taxpayer intends to challenge these consents.

With regard to the only extension consent secured after the [redacted] reorganization so far, it was executed in the name of the then-defunct old common parent. It is unlikely that this consent could ultimately be upheld as valid, though we may have certain equitable estoppel and/or equitable reformation of contract arguments available to us to validate it. Nevertheless, as a practical matter, this Form 872 is probably of little consequence since it unquestionably did nothing to bind the subsidiaries and since the common parent, new [redacted], is still liable as a transferee anyway. Despite that view, we would recommend that you continue to obtain timely Forms 872 from new [redacted].

We would recommend that the future Forms 872 (one of which should be obtained by [redacted]) be titled as follows:

> [redacted] (EIN [redacted]) as Successor by Merger to [redacted] (EIN [redacted], formerly named [redacted])

The EIN to be shown in the designated block of the Form 872 should be that of "old" [redacted] (*i.e.*, EIN [redacted]) so as to continue the "chain" of consents previously executed and to offer evidentiary support to an argument that we may have to make that this was the intent of the parties right along and that the previous Form 872 should be reformed to reflect that intent.

A transferee agreement, Form 2045, and a consent to extend the time for assessment against a transferee, Form 977, should also be secured from [redacted] (EIN [redacted]. These transferee consents should be our guarantee of holding the new common parent liable for any income tax due from the old group for the years in issue. Assuming that our stated position as to the validity of the pre-[redacted] reorganization consents executed by the old common parent were ultimately upheld, those consents would then run the statute against the original transferor until [redacted]. Under section 6901(c), transferee liability would then run against new [redacted] until [redacted], even without any transferee extension.[12]

Please contact Oreste Russ Pirfo at FTS 566-8665 should you have any questions or need further assistance.

MARLENE GROSS

By: Steven J. Hankin
STEVEN J. HANKIN
Senior Technician Reviewer
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[12] Given its liability as a transferee, this taxpayer may not attempt to challenge the Form 872 executed in [redacted]. That consent purportedly extended primary liability until [redacted]. That date coincides with the expiration of taxpayer's period of liability as a transferee under section 6901(c), before any further extension. Thus, we believe that the new common parent is liable as a transferee until the end of this year anyway, even if the [redacted] Form 872 were ultimately held invalid.